

CALIFORNIA HEALTH FACILITIES FINANCING AUTHORITY

**The HELP II Program
EXECUTIVE SUMMARY**

Applicant: Neighborhood Healthcare (“Neighborhood”) 425 North Date Street Escondido, California San Diego County		Amount Requested: \$400,000 Requested Loan Term: 15 years Date Requested: July 25, 2002 Resolution Number: HII-124	
Project Site: 855 E. Madison Avenue, El Cajon, California		Facility Type: Community Clinic	
Use of Loan Proceeds: Loan proceeds will be used by Neighborhood to refinance a 10.5% interest rate loan of an organization it is merging with. Neighborhood will save approximately \$30,000 per year in interest payments.			
Type of Issue:		HELP II Loan.	
Prior HELP II Borrower:		No	
Payments up to date:		N/A	
Financial Overview: The existing Neighborhood organization demonstrates strong debt service coverage and liquidity, but an increasing age of receivables. Neighborhood is taking over an organization with marginal operations, but proforma debt should be manageable for the merged organization.			
Sources of Revenue:			
		<u>Amount</u>	<u>Percent</u>
(FYE 6-30-01)	Third party	\$3,314,469	34%
	Managed care	1,444,899	16%
	Contracts	1,698,375	17%
	Grants	993,933	10%
	Donations/Capital campaign	760,826	8%
	Patient service revenue	596,264	6%
	Other	<u>951,715</u>	<u>9%</u>
	Total Revenue and Support	<u>\$9,760,481</u>	<u>100%</u>
<u>Estimated Sources of Funds:</u>		<u>Estimated Uses of Funds:</u>	
HELP II Loan	\$400,000	Refinance	\$400,000
Equity Contribution	<u>7,000</u>	Financing Costs	<u>7,000</u>
Total Sources	<u>\$407,000</u>	Total Uses	<u>\$407,000</u>
Legal Review: No information was disclosed to question the financial viability or legal integrity of the Applicant.			
Staff Recommendation: Staff recommends the Authority approve a resolution for a HELP II Loan for Neighborhood Healthcare in an amount not to exceed \$400,000 for a term of 15 years subject to a 1 st deed of trust acceptable to the Authority, evidence that the merger has become effective, and the standard HELP II loan provisions.			

STAFF SUMMARY AND RECOMMENDATION

NEIGHBORHOOD HEALTHCARE (“Neighborhood”)

July 25, 2002

Resolution Number: HII-124

I. PURPOSE OF FINANCING: Loan proceeds will be used to refinance an existing interest-only loan, saving approximately \$30,000 per year in interest payments and allowing Neighborhood to build equity in the property.

Refinance existing loan **\$400,000**

The existing loan is an interest-only loan which will mature in September 2002. This refinancing is projected to save Neighborhood approximately \$30,000 in interest expense per year (and approximately \$530,000 over 15 years), based on paying 3% versus the existing 10.5% rate. Although Neighborhood will now be making both interest and principal payments, cash flow will still improve by \$9,000 per year. An appraisal dated June 2001 valued the property at \$650,000, which results in a loan to value of 61.5%.

In 1994, East County Community Clinic (which will be merged with Neighborhood as of August 1, 2002) received a \$400,000 loan to supplement a \$690,000 block grant designated to construct clinics at two sites. This loan, which matured at the end of 2000, was an interest-only note held by an individual, and carried a 15% rate. Since taking over management responsibility for East County in 1999, Neighborhood could not find a bank willing to refinance the loan. In 2000, a director of the clinic agreed to refinance the loan for a two year period.

As a condition of the block grant, the County of San Diego negotiated an agreement to lease 45% of the clinic facility. In 1999, the lease (which originally was for 50 years with an option for an additional 50 years), was renegotiated to terminate in 2010.

Financing Costs		<u>7,000</u>
1. Authority Closing Fee	\$5,000	
2. Title/Escrow/Other.....	<u>2,000</u>	
Total		<u>\$407,000</u>

Financing structure: The Neighborhood financing will be structured as follows:

- 15 year loan term.
- 180 equal monthly payments of roughly \$2,765 (yearly payments of \$33,180).
- Total interest payments of approximately \$97,220.
- 1st lien on property located at 855 E. Madison Avenue, El Cajon, CA.
- Maximum loan to value of 95%. Expected 61.5% loan to value ratio (based on purchase price of \$650,000).
- Corporate gross revenue pledge.

II. FINANCIAL STATEMENTS AND ANALYSIS:

Neighborhood Healthcare Statement of Activities

Unrestricted

	For the 11	For the year ended June 30		
	months ended 5/31/02 (Unaudited)	2001	2000	1999
Unrestricted Revenue*:				
Third party revenue	\$ 3,314,469	\$ 3,166,101	\$ 2,451,391	\$ 2,223,490
Managed care revenue	1,444,899	1,529,939	1,142,216	715,709
Grant revenue	1,339,798	993,933	851,660	845,456
Contracts	855,202	774,527	678,895	1,050,731
Patient service revenue	508,981	596,264	506,611	470,943
Inpatient service revenue	604,616	545,621	297,489	102,752
Palomar hospitalist contract	507,183	511,048	320,296	-
Mental health revenue	244,214	267,067	190,290	157,752
Administrative services rendered	319,338	412,800	444,600	67,985
Donations	216,586	208,495	143,118	251,297
Pharmacy	265,221	-	-	-
Net assets released from restrictions	121,235	552,331	1,100,233	-
Other revenue	138,960	202,655	124,303	106,334
Total support and revenue	<u>9,880,702</u>	<u>9,760,781</u>	<u>8,251,102</u>	<u>5,992,449</u>
Expenses:				
Salaries & Benefits	6,854,094	6,068,838	5,030,287	4,149,758
Contract services	710,388	938,185	701,351	512,532
Supplies	720,180	570,889	485,442	412,320
Facilities	436,351	357,366	242,936	218,467
Equipment expense	233,817	251,380	113,895	73,935
Communications	181,470	168,798	108,834	87,612
Depreciation	148,016	167,993	86,023	92,248
Insurance	138,646	107,763	94,469	83,488
Mortgage interest	74,468	51,386	34,643	36,167
Other expenses	63,079	286,227	210,069	171,147
Total expenses	<u>9,560,509</u>	<u>8,968,825</u>	<u>7,107,949</u>	<u>5,837,674</u>
Increase (decrease) in unrestricted net assets	320,193	791,956	1,143,153	154,775
Unrestricted net assets, beginning of year	<u>3,792,521</u>	<u>3,000,565</u>	<u>1,857,412</u>	<u>1,702,637</u>
Unrestricted net assets, end of year	<u>\$ 4,112,714</u>	<u>\$ 3,792,521</u>	<u>\$ 3,000,565</u>	<u>\$ 1,857,412</u>

* Revenues are generally reported by program rather than source of revenue. However, Patient Service Revenue are patient self-payments, Third Party Revenue, Contract revenue, and Mental Health Revenues are predominantly Medi-Cal and other State payments, while Inpatient Service Revenue is mostly paid by Medicare & Medi-Cal, as well as managed care revenue.

**Neighborhood Healthcare
Statement of Financial Condition**

	As of May 31	As of June 30		
	2002 (Unaudited)	2001	2000	1999
ASSETS				
Current assets:				
Cash and cash equivalents	\$ 883,383	\$ 905,061	\$ 1,074,300	\$ 1,424,560
Accounts receivable	1,810,571	1,415,119	841,580	526,206
Inventory	70,778	70,778	66,946	57,495
Prepaid expenses	104,301	87,132	61,474	52,670
Other current assets	4,750	4,750	6,150	6,150
Total Current Assets	2,873,783	2,482,840	2,050,450	2,067,081
Property and equipment, net	4,150,727	3,302,566	1,442,993	1,414,492
Construction in progress	-	3,674	1,083,367	37,270
Total assets	\$ 7,024,510	\$ 5,789,080	\$ 4,576,810	\$ 3,518,843
LIABILITIES & NET ASSETS				
Current liabilities:				
Accounts payable	\$ 257,549	\$ 271,257	\$ 385,857	\$ 135,339
Accrued payroll expenses	622,336	357,060	308,702	283,987
Deferred revenue	368,947	225,737	198,700	202,135
Mortgage payable-current	29,664	25,603	17,294	15,653
Other current assets	80,197	80,198	12,868	19,923
Total current liabilities	1,358,693	959,855	923,421	657,037
Mortgages payable	1,485,605	915,378	375,690	394,231
Deposit	-	-	-	3,200
Total liabilities	2,844,298	1,875,233	1,299,111	1,054,468
Unrestricted net assets	4,112,712	3,792,521	3,000,565	1,857,411
Temporarily restricted net assets	67,500	121,326	277,134	606,964
Total net assets	4,180,212	3,913,847	3,277,699	2,464,375
Total liabilities and net assets	\$ 7,024,510	\$ 5,789,080	\$ 4,576,810	\$ 3,518,843

<u>Financial Ratios:</u>	Proforma (a)			
Debt Service Coverage (x) *	2.51	5.53	3.24	4.65
Debt/Unrestricted Net Assets (x)	0.54	0.25	0.13	0.22
Margin (%) *		2.60%	0.60%	2.58%
Current Ratio (x)		2.80	2.22	3.23

(a) Recalculates June 2001 audited results to include the impact of a full year of debt service on a construction loan that originated in March 2001, as well as a loan financing the acquisition of a leased facility in May 2002. These ratios also reflect the addition of all debt to be assumed from East County.

* For purposes of generating these ratios, Net assets released from restrictions, almost exclusively derived from a capital campaign, have been backed-out. Neighborhood will no longer earn revenue for 'Administrative Services Rendered' once the merger is complete. Due to the difficulty in specifically identifying the expenses directly related to this revenue, these revenues have not been backed-out from these ratios.

**East County Health Services
Statement of Activities
Unrestricted**

	For the 11 months ended <u>5/31/02</u> (Unaudited)	<u>For the year ended June 30</u>		
		<u>2001</u>	<u>2000</u>	<u>1999</u>
Unrestricted Revenue:				
Patient fees	136,328	\$ 202,294	\$ 171,663	\$ 269,442
Third party revenue	1,040,753	1,269,639	1,050,414	1,117,191
Managed care	1,039,802	1,015,189	1,225,235	959,670
Grants and Contracts	626,577	836,578	681,534	517,705
Reimbursement - UCSD	-	-	-	725,624
Scripps closure grant (after hours)	-	455,000	75,000	-
Donations	56,720	63,745	143,071	6,836
Net assets released from restrictions	-	618,471 *	47,000	50,000
Miscellaneous revenue	65,865	49,334	66,384	93,956
Total support and revenue	<u>2,966,045</u>	<u>4,510,250</u>	<u>3,460,301</u>	<u>3,740,424</u>
Expenses:				
Salaries & Benefits	1,809,123	2,217,263	1,950,864	2,069,601
Contract services **	673,950	907,886	823,582	667,181
Supplies	141,864	147,586	135,648	168,294
Facilities	251,609	218,600	245,104	243,451
Mortgage interest	44,359	60,805	69,645	62,933
Equipment	36,245	51,793	34,249	22,498
Communications	58,593	69,604	81,866	54,352
Depreciation	63,007	62,270	46,813	39,725
Insurance	63,514	62,145	63,100	71,927
Financing costs	5,718	6,755	13,319	38,595
Other expenses	25,834	40,621	25,129	41,832
Total expenses	<u>3,173,816</u>	<u>3,845,328</u>	<u>3,489,319</u>	<u>3,480,389</u>
Increase (decrease) in unrestricted net assets	(207,771)	664,922	(29,018)	260,035
Unrestricted net assets, beginning of year	<u>756,121</u>	<u>91,199</u>	<u>120,217</u>	<u>(139,818)</u>
Unrestricted net assets, end of year	<u>\$ 548,350</u>	<u>\$ 756,121</u>	<u>\$ 91,199</u>	<u>\$ 120,217</u>

Revenues are generally reported by program rather than by source of revenue. However, Patient Service Revenue are patient self-payments, Third Party and Mental Health Revenues are predominantly Medi-Cal and other State payments, while Inpatient Service Revenue is mostly paid by Medicare & Medi-Cal, as well as managed care revenue.

* A property acquired in 1994 was transferred from restricted to unrestricted classification once restrictions on its use and disposition expired.

** Contract services includes the fees paid, since 2000, to Neighborhood Healthcare for management services.

**East County Health Services
Statement of Financial Condition**

	As of May 31	2001	As of June 30	
	2002		2000	1999
ASSETS	(Unaudited)			
Current assets:				
Cash in bank	\$ 657,532	\$ 64,243	\$ 109,492	\$ 286,964
Accts receivable-Grants & Contracts	46,561	150,412	160,295	106,550
Accts receivable-Patient fees & Third party	405,173	305,667	226,392	165,904
Prepaid expenses	63,956	54,037	87,060	10,585
Other current assets	12,978	12,978	23,591	21,640
Total Current Assets	<u>1,186,200</u>	<u>587,337</u>	<u>606,830</u>	<u>591,643</u>
Property and equipment, net	<u>1,200,185</u>	<u>1,247,818</u>	<u>1,191,240</u>	<u>1,153,437</u>
Total assets	<u><u>\$ 2,386,385</u></u>	<u><u>\$ 1,835,155</u></u>	<u><u>\$ 1,798,070</u></u>	<u><u>\$ 1,745,080</u></u>
LIABILITIES & NET ASSETS				
Current liabilities:				
Accounts payable	\$ 525,498	\$ 372,056	\$ 209,551	\$ 104,204
Accrued personnel expenses	134,088	118,946	126,238	124,293
Deferred revenue	710,947	75,129	203,348	75,759
Note payable	13,432	37,112	50,000	-
Mortgage payable-current	25,632	23,786	21,584	143,344
Total current liabilities	<u>1,409,597</u>	<u>627,029</u>	<u>610,721</u>	<u>447,600</u>
Mortgages payable	<u>428,438</u>	<u>452,005</u>	<u>477,679</u>	<u>499,264</u>
Total liabilities	1,838,035	1,079,034	1,088,400	946,864
Unrestricted net assets	548,350	756,121	91,199	120,217
Temporarily restricted net assets				47,000
Permanently restricted net assets		-	618,471	630,999
Total net assets	<u>548,350</u>	<u>756,121</u>	<u>709,670</u>	<u>798,216</u>
Total liabilities and net assets	<u><u>\$ 2,386,385</u></u>	<u><u>\$ 1,835,155</u></u>	<u><u>\$ 1,798,070</u></u>	<u><u>\$ 1,745,080</u></u>

Financial Ratios:

Debt Service Coverage (x)	1.43 *	0.49	1.62
Debt/Unrestricted Net Assets (x)	0.68	6.02	5.35 *
Margin (%)	1.19% *	-0.84%	6.95%
Current Ratio (x)	0.94	0.99	1.32

* In 1994, East County recorded \$618,471, previously classified as restricted net assets, as unrestricted revenue. This was due to the passing of time restrictions on the disposition of assets purchased in 1994.

Debt service coverage and the margin for 2001, shown above do not include this one-time event.

Debt/Unrestricted Net Assets for 1999 and 2000 (before the transfer of net assets to the unrestricted classification) would have been 0.87x and 0.77x respectively if \$618,471 had been classified as unrestricted net assets.

Financial Discussion:

The existing Neighborhood organization demonstrates strong debt service coverage and liquidity, but an increasing age of receivables.

Neighborhood has been profitable through our review period, leading to debt service ratios in excess of 3.0x and current ratios in excess of 2.0x.

Neighborhood's revenues have increased by 48% since 1999 (not including capital- campaign revenue and revenue it has earned since 2000 for administration of East County), due largely to a 29% increase in encounters. Unrestricted net assets have more than doubled in this period.

In addition to Neighborhood's already diverse revenue sources, in fiscal 2000, Palomar Medical Center contracted with Neighborhood to provide two physicians to admit and care for individuals without personal physicians who come to the emergency room. Also, Neighborhood has been approved for approximately \$521,000 in Cedillo-Alarcón grant funds (and East County was approved for \$350,000).

Of some concern are the increasing receivables, which have more than tripled since 1999. Management states that this is due, in part, to receiving an increased amount of grant revenue and private insurance revenue (such as the Palomar Medical Center program) which have typically taken longer to collect. Also, according to management, although approximately 20% of receivables are aged over 90 days, the majority of this amount is administrative contract fees they have not collected from East County.

Neighborhood is taking over an organization with marginal operations.

The directors of both entities have approved the merger of East County into Neighborhood, expected to take effect on August 1, 2002. A number of cost savings are expected, including a consolidation of the accounting function.

In fiscal 2000, East County's board contracted with Neighborhood for accounting, billing and management services for a monthly fee of \$34,400 (\$412,800 annually). As a result of the management agreement, seven East County positions were eliminated as well as a contract with outside billing and accounting firms. East County, since 1994, had been managed under an agreement, whereby UC San Diego agreed to reimburse losses (and share in profits, if any). In 1999, UCSD made a final payment to East County, covering what had been a negative unrestricted net asset balance.

Under Neighborhood's management, despite losing a considerable amount of clients due to reforms to Medi-Cal managed care in San Diego, East County held the line on total expenses, found additional contract opportunities and performed fundraising to ensure only a minor loss in 2000 and paid-off approximately \$124,000 in maturing loans.

In 2001, however, with significant increases in personnel (they hired additional staff to expand services to 12 hours a day, 7 days a week once the nearby Scripps hospital closed) and other expenses, East County would have suffered a loss of approximately \$400,000 if it were not for a one-time grant from Scripps. East County, for the 11 months ended May 2002, has suffered a somewhat reduced loss of \$270,778 (about \$295,000 annualized) due to reduced personnel and contract services of about 11% and 19% respectively. Management reports, however, that an FQHC settlement is imminent, which will represent an additional \$190,000 in revenue.

Of some concern is that, while third party revenue has increased slightly, the receivable has increased by 84%. As of May 31, 2002 East County is only slightly liquid (if administrative contract fees totaling \$319,000 payable to Neighborhood are backed-out).

Proforma debt should be manageable for the merged organization.

With the addition of the debt it will assume from East County (including this refinanced loan, and two loans Neighborhood incurred late in fiscal 2001 and in May 2002, detailed below), Neighborhood’s proforma debt service coverage is 2.51x, which should be more than enough to withstand any operating losses the organization may suffer from the East County operations in the short-term. Also, the addition of East County’s debt leaves Neighborhood with a very manageable 0.54x debt to unrestricted net asset ratio.

Neighborhood completed construction of its Wellness Center in March 2001, costing approximately \$1.9 million, using a \$567,000 loan with the balance derived from fundraising. In May 2002, Neighborhood paid \$810,000 for a clinic facility that it had been leasing, using \$250,000 in Cedillo-Alarcón grant funds plus a \$600,000 loan. Loan payments are \$4,000 less than their previous lease payments.

III. UTILIZATION STATISTICS:

**Neighborhood Healthcare
Patient Encounters**

**11 months
ended May**

Fiscal Year June 30

Type of Service

2002

2001

2000

1999

Medi-Cal	42,781	38,026	37,431	30,030
Self pay	11,479	14,894	13,251	11,354
Family Planning	11,509	10,469	9,168	8,682
Child Health Disease Prevention	5,167	5,327	7,108	7,847
Medicare	5,937	5,177	1,933	2,254
Expanded Access to Health Care	5,278	3,427	3,835	5,348
Private insurance	2,384	2,402	583	698
Other programs	10,504	10,746	8,257	6,905
Totals	95,039	90,468	81,566	73,118

**East County Community Clinic
Patient Encounters**

11 months

ended May

Fiscal Year June 30

Type of Service	2002	2001	2000	1999
Medi-Cal	13,822	16,862	17,525	24,239
CMS	4,809	6,305	6,279	7,513
Self pay	4,521	7,366	6,087	7,198
Family Planning	2,554	2,507	1,978	1,760
Child Health Disease Prevention	1,080	1,609	2,124	2,678
Medicare	1,169	1,349	1,410	788
Expanded Access to Health Care	1,342	1,096	1,200	336
Private insurance	322	315	157	150
Other programs	2,130	2,208	1,889	1,045
Totals	31,749	39,617	38,649	45,707

IV. ORGANIZATION:

Background: Neighborhood Healthcare (formerly Escondido Community Clinic) is a private non-profit community health center. It began providing services in 1969 as an all-volunteer clinic in a space donated by the city of Escondido. Services include pediatric and adult primary care, urgent care, prenatal care, midwife care, family planning, HIV testing and care, women's health, dental services, counseling, health education and immunizations, as well as community outreach programs. Neighborhood has approximately 200 full and part time staff and 50 volunteers. Neighborhood operates in 6 clinic locations and operates a hospitalist program under contract with Palomar Medical Center.

As of August 1, 2002, Neighborhood Healthcare is to merge with East County Health Services, a non-profit primary care organization incorporated in 1974. Currently, East County is the largest provider of primary care in its area through its three clinic locations in El Cajon, La Mesa, and Lakeside (which are all approximately 30 miles from Escondido). East County has approximately 60 staff members providing services including pediatrics, adult medicine, family planning, and immunization clinics. Since May 1999, Neighborhood has provided executive, accounting, billing, information systems, human resource, and medical management services under contract with East County.

Licenses: Both Neighborhood and East County are licensed as community clinics by the California Department of Health Services.

Competition:

Neighborhood Healthcare is either the only provider of primary care to the uninsured and underserved, or is the largest provider of care, in Escondido, Temecula, and rural Pauma Valley. North County Health Services is a nonprofit federally funded community health center with its main center located in San Marcos six miles from Escondido. The two organizations work closely together and have some patients who use both centers. Palomar Medical Center, the local hospital in Escondido, is located within a few blocks of all of the Escondido facilities, and relies on the health centers for follow up care and to relieve the pressure of primary care in the emergency department.

East County's clinics are the oldest and largest primary care providers for indigent patients in their service area. The only other clinic in the El Cajon area is the Family Health Center, 3 miles away, with 4,000 encounters per year. East County reports that it is the largest recipient of referrals from the Grossmont Hospital emergency room, which has handled an increasing number of primary care patients since a local Scripps hospital closed two years ago.

V. OUTSTANDING DEBT:

<u>Description</u>	<u>Original Amount</u>	<u>Amount Outstanding As of 5/31/02</u>	<u>Estimated Amount Outstanding After Proposed Financing</u>
Existing:			
<u>East County:</u>			
John Pifer (855 E. Madison)	\$400,000	\$400,000	\$ 0
Palmer (Lakeside clinic)	\$195,000	\$54,070	\$54,070
Community Health Group (operating loan)	\$50,000	\$13,432	\$13,432
<u>Neighborhood:</u>			
Wells Fargo Bank (Valley Pkwy)	\$423,000	\$358,675	\$358,675
Wells Fargo Bank (Wellness Ctr)	\$567,367	\$558,252	\$558,252
Wells Fargo (Elm St.)	\$600,000	\$598,342	\$598,342
Proposed:			
CHFFA HELP II Loan, 2002			\$400,000
TOTAL DEBT		<u>\$1,982,771</u>	<u>\$1,982,771</u>

VI. SECTION 15438.5 OF THE ACT: With the proposed HELP II Loan, Neighborhood will save approximately \$30,000 per year in interest expense compared to its current loan payments. Neighborhood will use these savings to offset its costs of uncompensated care for indigent patients, allowing it to maintain or expand its existing level of services without raising rates.

VII. LEGAL REVIEW:

Staff has reviewed the Applicant's responses to the questions contained in the Legal Status portion of the Application. No information was disclosed to question the financial viability or legal integrity of this applicant.

VIII. STAFF RECOMMENDATION: Staff recommends the Authority approve a resolution for a HELP II Loan for Neighborhood Healthcare in an amount not to exceed \$400,000 for a term of 15 years subject a 1st deed of trust acceptable to the Authority, subject to evidence that the merger has become effective, and subject to the standard HELP II loan provisions